It's the law: Residential lease extensions

Lease Sir, can I have some more?

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"A shared owner who has not completed final staircasing presents a conundrum – there are different views about whether or not they will qualify to extend via the statutory process."

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A long lease is a wasting asset. The clock starts ticking the day it is granted, and every year that passes makes the flat a little harder to sell and a little harder to mortgage. The good news is that the law gives most leaseholders a way to wind the clock back – and reform now working its way through Parliament promises to make that even easier. This edition of It's the law explains how lease extension works, who qualifies, and what to watch for. It should take you about five minutes to read – rather less time than it takes a short lease to become a problem.

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Then and now

Leases have been around since long before Charles Dickens penned his first novel. The concept of distinguishing between different degrees of title to property ownership was introduced to England in 1290 by the Statute Quia Emptores.

635 years later we got the Land Registration Act 1925. From then onwards the legal title you could own in a property was limited to two categories:

- Freehold (which, for practical purposes, is title forever).
- Leasehold (which is title limited to a fixed period, known as 'the term').

Nowadays we also have the concept of commonhold, and the Government has signalled that it wants it to become the default way of owning a flat in future, but whatever the long-term direction of travel, leasehold is not going anywhere fast: the millions of existing leases will remain firmly in the leasehold world, and everything in this edition will stay relevant to them for a considerable time to come. So, for the purposes of this edition of It's the Law we, like almost everybody else, will keep our focus on leasehold.

We are looking here at residential leases, not short lets and not periodic tenancies, but the sort of lease someone who wants to own a flat might buy. Terms of 99 or 125 years are probably most common.

As time goes by

The fact that the lease will come to an end eventually will impact its attractiveness – and as such affects the ease of sale, and value, in future years. That impact gets progressively worse as time goes by. Mainstream lenders have policies about the minimum terms left to run that they will accept as security. That varies from lender to lender but commonly it's around 80 years.

There is a further reason 80 years matters. Under the current valuation rules, once a lease drops below 80 years unexpired the premium payable to extend it includes an onerous element called 'marriage value' which can add a substantial sum to the bill. Extending before the lease crosses that threshold has therefore long been the conventional wisdom – though, as we will see, reforms may be about to change the picture.

So, whilst the buyer of a leasehold property may complete their purchase with Great Expectations, careful consideration should be given to the length of the lease left to run, to ensure that they are not left with a Bleak House (or, in this case, flat).

How to avoid hard times

Luckily, the Leasehold Reform, Housing and Urban Development Act 1993 (we'll call it the Act for short) comes to the rescue.

The Act provides a statutory right for the owner of a lease of a flat to buy an extension of the remaining term, provided they satisfy certain criteria. If they do, then they are known as a 'Qualifying Tenant' and they may be entitled to a new lease which has an additional 90 years added on top of their then remaining lease term.

Their annual ground rent will be reduced to a peppercorn (i.e. nothing), which is another win for them. Amendments, other than the term and rent, can be agreed if the lease requires updating to bring it into the 21st century.

Change on the horizon. The Leasehold and Freehold Reform Act 2024 will, once fully in force, replace that 90 year uplift with a 990-year extension, and abolish marriage value altogether. We come back to what that means (and what is and is not yet in force) below.

How to qualify

In order to consider yourself a Qualifying Tenant, the following criteria must be met:

- **You must hold a long lease of your flat.** The Act defines that as a lease granted for a term of more than 21 years. It is the whole term initially granted that matters, not the length of term remaining at the time.
- **You must be a residential tenant.** The provisions of the Act do not extend to business tenants. They tend to be looked after by the Landlord and Tenant Act 1954, which is a whole different ball game.

One thing that has recently changed for the better. Until 2020 a tenant also had to have been the registered owner of the lease for at least two years before applying. That two-year ownership requirement was abolished with effect from 31 January 2020, so a buyer can now start the process straight away rather than waiting.

An exception applies where the tenant's immediate landlord is a charitable housing trust and the flat forms part of the housing accommodation provided by it in the pursuit of its charitable purposes. This is a narrow exception and the fact that the landlord is a charitable housing trust does not, of itself, prevent a long leaseholder from being a Qualifying Tenant.

A word on shared ownership

Shared ownership adds a wrinkle. Our view is that a shared owner whose lease was originally granted for a term exceeding 21 years would appear capable of qualifying as a qualifying tenant for a statutory lease extension under the 1993 Act, whether or not they have staircased to 100 percent.

Following the Court of Appeal's decision in Avon Ground Rents Ltd v Canary Gateway (Block A) RTM Co Ltd [2023] EWCA Civ 1268, where Newey LJ held that the limits of the definition of 'long lease' under Section 76(2) of CLRA 2002, operate as alternative gateways: the 21-year limb applies even if the limb dealing with fully staircased shared ownership leases does not. The case concerned the right to manage under CLRA 2002, but section 7(1) of the 1993 Act is drafted in materially the same terms as Section 76(2) of CLRA 2002 and the Court expressly worked through the 1993 Act authorities.

The point has not been decided under the 1993 Act itself, so it is not beyond argument. But, registered providers should assume that a section 42 notice from a part-staircased shared owner has to be answered on its merits, and should be alive to the consequences: a peppercorn ground rent, valuation of the retained share, and the effect on income streams and lender security.

The Leasehold and Freehold Reform Act 2024 will put the matter beyond doubt, but the relevant provisions are not in force, and no commencement date has been set. Specific advice should be taken where the point arises.

In the beginning

The first step for a Qualifying Tenant intending to exercise their rights is to serve a notice of that intention. The notice must be in writing (which for these purposes rules out email). Although there is no prescribed form, the Act sets out certain information that must be included, such as the tenant's details and the premium that they are willing to offer in return for the extension.

The notice must be served on the 'Competent Landlord', who may be the freeholder of the block, or the owner of a headlease which is sufficiently long to grant a 90-year extension. There may also be other landlords with an interest in the property who need to be notified of the claim. If the notice is not completed and served correctly the landlord may have grounds to reject it. If they do, the tenant will have to go back to the beginning.

Bargain hunter

For the notice to be valid, the premium offered to the landlord must be realistic. A Qualifying Tenant would be well advised to appoint a valuer to make sure they get it right. Tenants tend to want to offer a premium towards the lower end of what can be considered reasonable, in the hope of a good deal. But go too low and they risk the notice being held invalid.

It's good to talk

The landlord is entitled to make a counter-offer with a higher figure. If a counter notice is served, a negotiation period commences during which the tenant's surveyor and the landlord's surveyor discuss their calculations with a view to agreeing the premium. If no counter notice is served by the landlord, the tenant may apply to the County Court for a vesting order, meaning the lease will be granted on the terms proposed in the initial notice.

For this reason, it is crucial for landlords to respond within the prescribed time. Large organisations (in particular) should ensure they have systems in place so that notices received are dealt with promptly and it should be borne in mind that the parties cannot agree extensions of time to these statutory deadlines. As such, a missed counter notice deadline can be a very expensive mistake for a landlord to make.

Costly business

As soon as the Qualifying Tenant serves the first notice, they become liable for the landlord's reasonable legal and valuation costs. The tenant can also be required to pay a deposit of 10% of the premium offered or £250, whichever is higher. Note that reform (below) is expected to change the costs position so that, in future, each side will generally bear its own costs.

Off to court

If the surveyors agree the premium and the terms of the new lease, the extension can be progressed. If not, both the Qualifying Tenant and the Competent Landlord have a window (following the expiry of the statutory two-month negotiation period and running to six months from the date of the landlord's counter notice) in which to apply to the First-tier Tribunal for a determination of how much should be paid and what the terms of the new lease should be.

Home stretch

Once negotiations are finalised and the lease is agreed (or determined by the Tribunal) and completed, the lease extension is registered at the Land Registry. The lease extension is itself a new lease, and the original lease is treated as having been surrendered. If the original lease was subject to a mortgage, that mortgage will essentially transfer to the new lease.

That'll cost you

If the Qualifying Tenant does not complete the lease extension within the required timescales, or does not apply to the Tribunal in time, they will temporarily lose their rights. They can start the process again, but only after 12 months – and they will still be liable to pay the landlord's costs already incurred.

The voluntary route

Not every extension goes down the statutory road. A landlord and tenant are free to agree a lease extension by negotiation, on whatever terms they choose – known as a voluntary, contractual or 'informal' extension. This is common where the tenant does not qualify for the statutory right, or where the parties simply want to move more quickly than the statutory timetable allows.

The trade-off is that there are no statutory protections: the term, the ground rent and the premium are all up for negotiation, and either party can walk away at any time before completion. Because the extension still takes effect as a surrender and re-grant, both covenants and the treatment of existing security and restrictions all need to be handled with care. And watch the ground rent: for a new lease granted on or after 30 June 2022, the Leasehold Reform (Ground Rent) Act 2022 requires that no more than a peppercorn is charged for the extended term.

Safe as houses

A tenant of a house (rather than a flat) may also be entitled to a lease extension. The law governing leasehold houses is different and falls within the Leasehold Reform Act 1967. Unlike with flats, tenants of houses have two options: to extend their lease by an additional 50 years, or to enfranchise (a fancy word for purchasing the freehold).

On a lease extension under the 1967 Act no premium is payable, but the landlord is currently entitled to increase the ground rent to a modern rent. On enfranchisement, the premium payable to the landlord is the market value of the freehold. In practice the extended lease is rarely used – it is at a modern ground rent and does not solve the mortgagability problem – so the freehold is usually the prize. As with flats, the starting point is the tenant serving formal notice, and disputes can be referred to the First-tier Tribunal.

The mechanism for freehold enfranchisement under the 1967 Act is often described as complex and we would strongly recommend that advice is sought prior to serving or responding to a notice of claim.

It is also important to note that the premium on a freehold enfranchisement claim is not referred to within the notice of claim or landlord's response, and will be negotiated, following acceptance of the tenants right to the statutory claim under the Act.

"Collective enfranchisement can hand leaseholders the freehold, and with it the building's safety liabilities. Best to proceed with caution and take appropriate advice."

Tasha Tabannor-Robinson
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Strength in numbers

Where a whole block is involved, the leaseholders may be able to club together and buy the freehold of the building between them – a process known as collective enfranchisement, also under the 1993 Act. Broadly, at least two-thirds of the flats in the building must be held by qualifying tenants, and qualifying tenants of at least half of the flats must participate in the claim. They can then require the freehold to be sold to a nominee purchaser, which may be a company they set up for the purpose. It is a powerful right, but not always the answer: where the tenants' real objective is simply better management rather than ownership, the Right to Manage route may achieve the same result more cheaply and without taking on the freeholder's liabilities.

One important health warning. Acquiring the freehold of a block means stepping into the landlord's shoes – including for building safety. Where a building is over 11 metres (and especially at 18 metres or seven storeys and above), the Building Safety Act 2022 imposes significant, ongoing and criminally enforceable duties, and remediation liability for historic defects can be substantial. Leaseholders considering enfranchisement of a building should take specialist advice before they commit.

Current affairs

The law and practice around lease extensions and enfranchisement has been under review for years, with successive Governments agreeing that the system does not represent a fair deal for leaseholders. That review has now produced legislation: the Leasehold and Freehold Reform Act 2024.

Some of it is already in force. The two-year ownership requirement has gone, as noted above. But the headline changes – the move to 990-year extensions, the abolition of marriage value, and a new prescribed valuation methodology – are not yet operative. They require secondary legislation, some technical flaws in the Act need fixing, and aspects of the valuation reforms have been the subject of litigation. Further reform is also promised through a Commonhold and Leasehold Reform Bill, with the longer-term aim of making commonhold the default for new flats.

What this means in practice. The direction of travel is clear, but the timing is not, and for now the existing rules still apply. That uncertainty is itself a live issue: leaseholders with short leases may be weighing up whether to extend now or wait for the reforms to bite, while landlords are alert to the fact that reform is likely to weaken their negotiating position. Anyone with a decision to make in this area should take advice on the current position before acting.

This document is part of Devonshires' 'It's the law' series, tailored for people working in development and regeneration. All reasonable precautions have been taken to ensure that the information contained is materially accurate. However, this document is not intended to be legally comprehensive, and no action should be taken on the matters covered without seeking specific legal advice.

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